RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

Oct. 7, 1987 **LETTER 975**

Sept. 25 DJIA 2570.17; PTI 2674; A-D Ratio -6.65
Oct. 2 DJIA 2640.99; PTI 2693; A-D Ratio -6.19

THE MARKET: I've said this before, but I'll say it again. *There's nothing more difficult than operating in the market when the Averages are fluctuating between the last primary highs and the recent secondary lows.* And that, by the way, is exactly where we are now.

In view of the above, let's review the recent price action and try to make sense out of what has happened so far. Amid an atmosphere of extreme bullishness, the D-J Industrial and Transportation Averages recorded highs of 2722.42 and 1101.16 in August. Those figures represent the primary highs for this bull market. From the August highs the two Averages dropped sharply for a period of almost six weeks. The Industrial Average recorded a reaction low of 2492.82 on September 21. On the same day the Transports hit a reaction low of 1005.80.

In terms of points, Industrials lost 229.60 points on their decline from the August high to the September low. In terms of points, Transports lost 95.36 points from the high to the low. I think these losses are substantial enough and the elapsed time long enough so that we can now label the August-September decline a full reaction.

Following the September 21 lows the two Averages rallied. This (current) rally is extremely important. Why? Because what happens from this point on will tell us (in Dow Theory terms) whether we are still in a bull market -- or whether the tide has turned in favor of the bear.

Again, for newer subscribers, I want to explain how a Dow Theory bear signal works. First, the Averages must turn down from the highs and a full correction must occur. The correction must last a few weeks or longer, and retrace a substantial portion of the previously uncorrected advance. Next a rally will take place, and the rally will either take ***both*** *Averages to new highs or it won't. If it does take both Averages to new highs, then obviously we are looking at a reconfirmed bull market. But if* ***one or both*** *Averages fail to go to new bull market highs, and the Averages turn down, at the point where both Averages break their previous lows a primary bear market will be signaled.*

So as difficult and frustrating as this market has been, it has now placed itself in a position where it MUST say something definitive. The action of the D-J Averages from here will tell us whether the bull market is to be resumed -- or whether history will show mid-August to be the time when the great bull market bowed out and the bear took over.

Question: Russell, what do you personally think the resolution is going to be?

Answer: I should sidestep this question by saying that what I think doesn't matter -- that the Averages will give us the true answer when they are ready. But I will offer some opinions.

The Averages are now well off their September 21 lows. The bears have had their innings, and the bulls are now at bat. I think it is very possible that the D-J Industrials and Transports can run up to the highs. Possibly both can make new highs, in which case a reconfirmation of the primary bull trend will be signaled.

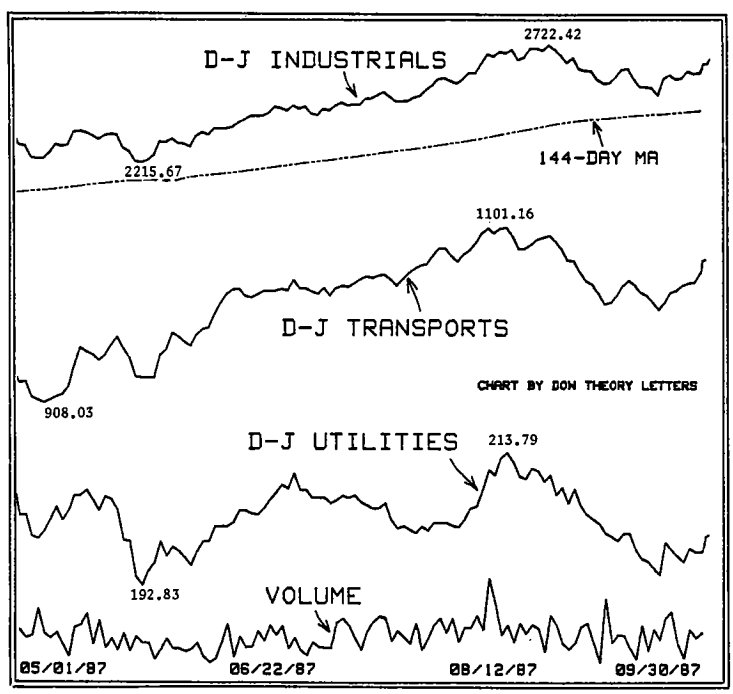
However, the breadth of the market (page 2 chart) remains a major problem. So far on the rally the A-D ratio has been sluggish, and this can be seen in the profile of DowPow. It is well to remember that the A-D ratio topped out last March 25. A new high in the Dow with a second major non-confirmation by the A-D ratio would have important negative implications. Frankly, I don't see the A-D ratio going to new highs even if one or both of the D-J Averages better their August peaks.

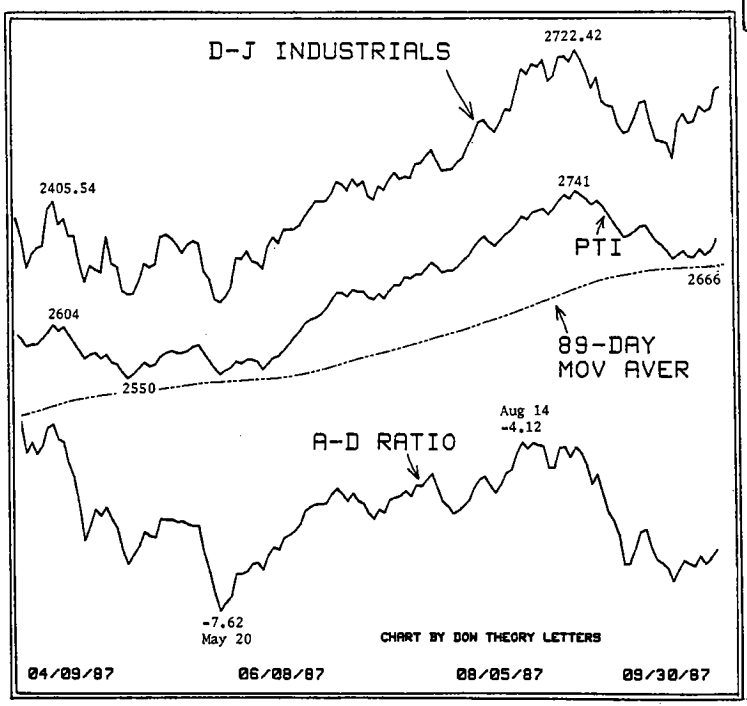
How about the PTI? The PTI, as it has done a few times since 1984, declined to within 8 points of its 89-day moving average and then rallied (see page 2 chart). So far, it has NOT been much of a rally, but the PTI did show important downside resistance when it got within shooting distance of its moving average. The PTI will remain in a bullish mode unless or until it breaks and remains below its 89-day moving average.

As I stated above, the plus in the current situation is that the market has finally put itself in a pattern where it will be forced to render a decison as to whether the primary trend is still bullish -- or whether the bear has taken over. The Wall Street gurus and mavens have been issuing their almost uniformly bullish predictions all year. But the time is drawing near when the only real authority on the market is going to speak. That authority is, you guessed it, the market itself.

Question: What affect is the monetary situation having on the stock market?

Answer: Monetary growth has been slowing all during 1987. The M-2 money supply grew at a 5.2% rate for the 12 months ending in August, the slowest rate since 1975! Ordinarily this slow growth would call for lower interest rates, but the Fed, frightened of inflation, has acted opposite to expectations and boosted the discount rate.





As a rule, slow money growth is reflected in the economy about a year later -- suggesting that the US could be on the verge of recession by late winter or spring. All of this "should" be spurring the bond market, but there is a new fear in the world of bonds. That fear is the specter of a collapsing dollar.

Few people are aware of it, but the real US trade deficit is now improving, and US exports are picking up. A recession would constrict US import buying, and many are saying that the US actually "needs" a mild recession. Is this what Fed Chief Alan Greenspan is thinking about? My guess is that it is, and that Greenspan would not be averse to a business slowdown or even a recession (of course, the usual procedure is to try to slow the economy the year before a coming election, then jazz up the economy just in time for the election).

Of course, the monetary situation affects the stock market in a more direct way. That way is the *value comparison between stocks and bonds*. As of last week the spread between the Dow yield and Barron's High-Grade bond yield was a near-record 7.31% in favor of bonds. Try compounding that 7.31% over five years, and you can see that the Dow would have to rise nearly 40% by 1992 in order to equal the return provided by bonds.

INVESTMENT POSITION: It's a bit frustrating, but the question mark is going to rule this box until the market gives us the word. That word will either be "bull" or "bear," but I'm not going to be egotistical enough to state that I can outguess the market. Frankly, I'm as curious as to the market's ultimate verdict as you are.

?

Meanwhile, almost to a man (and woman) the consensus among the "smart people" is that the bull market is still intact -- it's merely resting. If so, the ultimate resolution to the market's hesitancy will be new highs in both the Dow Industrials and Transports.

In the meantime, remember Russell's adage: The market will do whatever it has to -- to drive the largest number of people up the wall (while at the same time costing the greatest number of people big chunks of their savings).

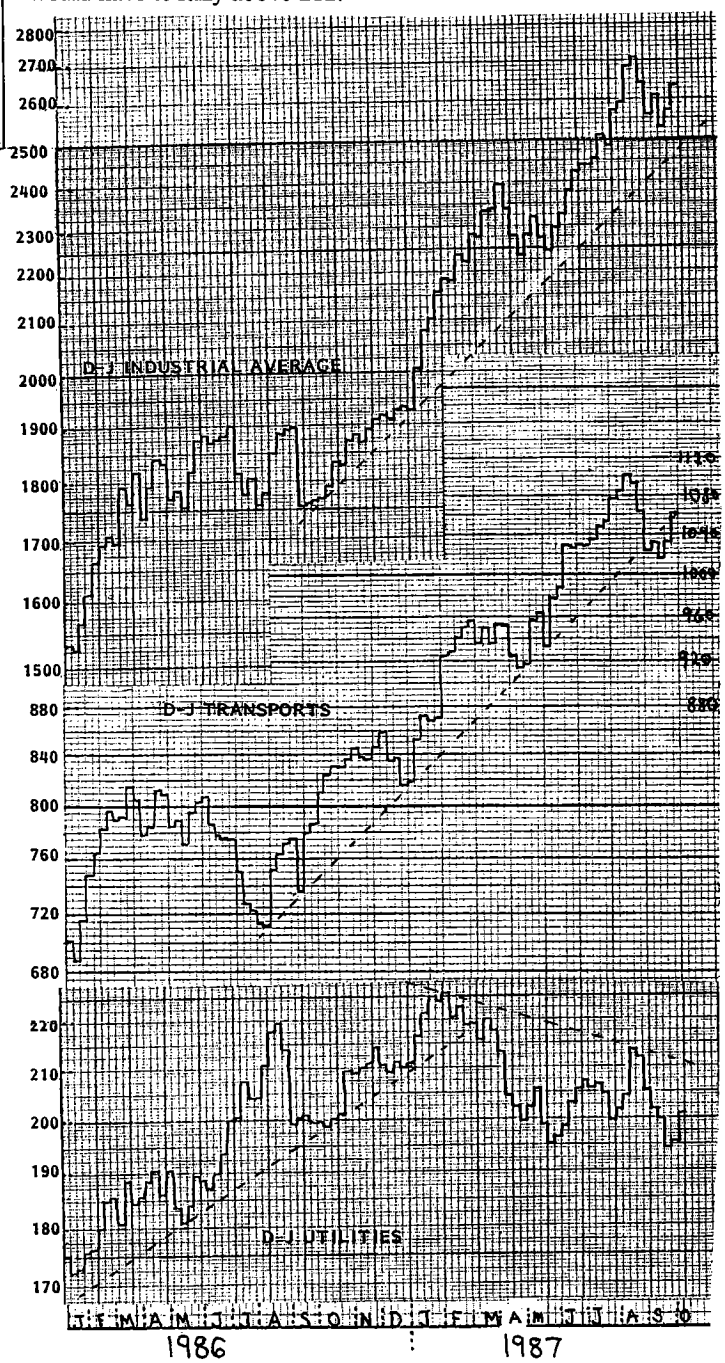
The bullish consensus for bonds over the last three weeks was 27%, 25%, and the latest 22%. This is about as low as it ever gets.

When everybody is bearish (or bullish) everybody is close to being wrong. When it comes to bonds, there's not a bull in the herd.

BIG VIEW: Every once in a while I feel it is worthwhile to step back and take a larger view of the D-J Averages. This chart presents the three Averages (weekly closings) in semi-log form. Semi-log or ratio scale presents the price action in terms of percentages. For instance, a rise of 100 to 200 on this chart will occupy the same vertical distance as a rise from 500 to 1000 or a rally from 2500 to 5000. In this way, all advances and declines can be correctly compared.

Another great advantage of ratio charts is this: Any up-slanting trendline drawn on a ratio chart portrays the price action in terms of a consistent rate of growth. When that trendline is violated, it means that the growth rate has changed. The same can be said (in reverse) when a down-slanting trendline is drawn on a ratio chart.

Note that up to January 1987 it was the Utility Average which was showing the outstanding growth rate. But the Utility Average topped out on January 22, and since then it has been showing a declining growth rate. To reverse this trend the Utility Average would have to rally above 212.



In the past the Utility Average has possessed bellwether characteristics -- particularly as pertains to interest rates. A topping Utility Average can have a very long lead-time before trouble hits the general market. Nevertheless, it is a definite negative that the Utility Average is now in a downtrend.

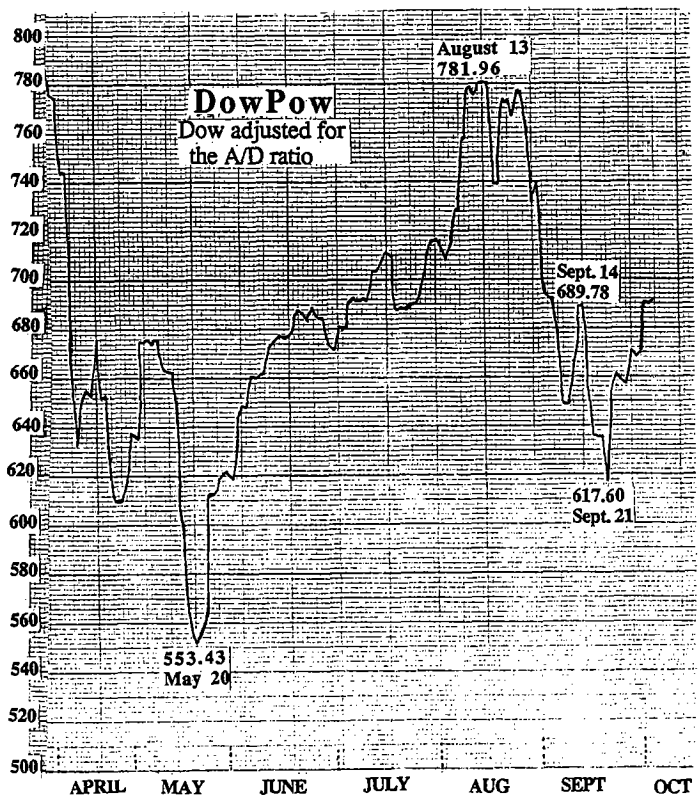
The strongest of the three Averages is obviously the Industrial Average. The rising growth trend in Industrials is still intact, and the Dow would have to break below its trendline or to 2425 before we could say that its rising trend is reversed.

Not so the Transportation Average -- the rising trend in Transports was broken three weeks ago when the Transports fell below the 1020 level.

So here's the picture: The Industrials are still in a bullish trend, the Transports have just reversed their bull trend, and the Utilities have been in a bear trend since January. Conclusion: The market is turning erratic if not actually weak. The Averages can yet "straighten themselves out," but until they do caution is warranted.

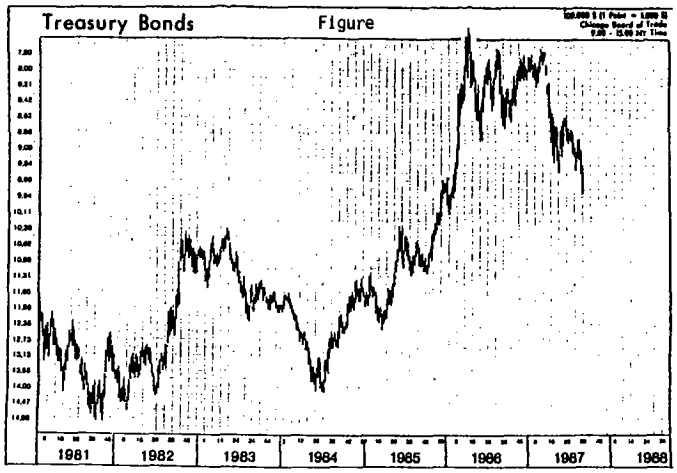
DowPow is my new indicator of the Dow adjusted for the advances and declines. DowPow recorded a low of 617.60 on September 21, then rallied to the 670 level last week. The boundaries for DowPow are clear -- the August 13 high of 781.96 on the upside and the September low of 617.60 on the downside.

DowPow measures the power of each successive advance compared with the power of each successive decline. The mid-range for DowPow over the last seven months has been 696. Currently, DowPow is holding below the mid-range. To me, that suggests weakness. A break below the September low of 617.60 would suggest further and increasing weakness. Conversely, any rise above 696-700 (the mid-range) would be bullish.



BONDS: The consensus is that "bonds are in a bear market." Many of my subscribers own bonds (or at least have a vital stake in interest rates), and I thought this was a good time to examine bonds from the long-term viewpoint.

The first chart shows the Treasury bond contract taken back to 1981. The picture here is obvious and shows why people are



bearish on bonds. Bonds have been going down ever since early-1986. But, of course, that's history. And we don't know whether the two-year decline is nearing an end -- or whether there is more to come.

The second chart (courtesy of Aden Analysis, 2400 Jefferson Highway, Jefferson, LA 70121) is most interesting in that it traces the path of the D-J 20-Bond Average all the way back to 1930. Seen here, the decline of the last two years tells a potentially different story.

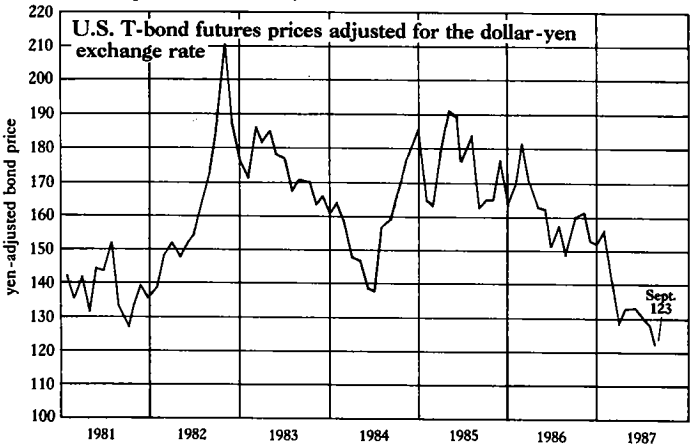
The 43-year trendline is probably the longest trendline in the financial world. But then we see the NL ("neckline") resistance trendline, and we realize that what we could be looking at is a huge "head-and-shoulders" bottom in the bonds. On that basis, the decline since 1986 could be simply the right shoulder. If so, this would suggest the bonds are moving into a tremendous buying area now.

The future of bonds depends a great deal on the stability of the dollar. And the stability of the dollar, in turn, rests on the US's willingness to pare its deficits. The trend of the deficits is crucial at this point because so much of the newly-issued US debt is bought by foreigners (particularly the Japanese).

The accompanying chart (from friend Jim Grant's, Grant's Interest Rate Observer, 233 B'way, NYC 10279) illustrates the ghastly losses that Japanese holders of US bonds have sustained since the high in 1982. Then why, you ask, do the Japanese continue to buy US debt? The only answer I can think of is the old saw, "Hope springs eternal."

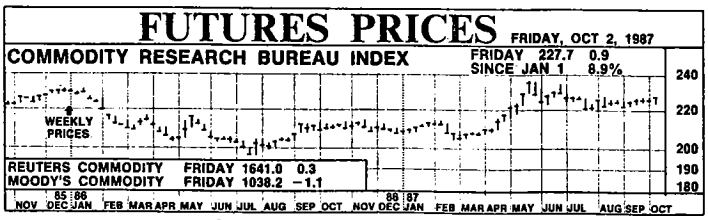
Russell Opinion: There is much talk of inflation now, and some of the latest statistics suggest a rise in inflation -- maybe to the 6% level. Most of the rise has been brought on by a weak dollar with accompanying higher prices for foreign goods. (Note: instead of allowing the price advantage of a cheap dollar work to their

For Japanese holders, a new low



advantage, our greedy domestic car manufacturers immediately raise their car prices and stamp out the cheap-dollar advantage.)

I could be wrong, but I am skeptical of any important rise in inflation. Gold has been surprisingly sluggish and the CRB Commodities Futures Index has hung around the 223-25 area as if it was glued there (see chart).


FUTURES PRICES
FRIDAY, OCT 2, 1987
COMMODITY RESEARCH BUREAU INDEX
FRIDAY 227.7 0.9
SINCE JAN 1 8.9%
WEEKLY PRICES
REUTERS COMMODITY FRIDAY 1641.0 0.3
MOODY'S COMMODITY FRIDAY 1038.2 -1.1
240
220
200
190
180
85 86
NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC 86 87 JAN FEB MAR APR MAY JUN JUL AUG SEP OCT

There is another factor in the picture. Over the past 10 years and even over the past five years the US public has become infinitely more sophisticated and money-wise. Everybody is into money funds, bond funds, stock funds, business news, financial magazines. Local TV stations are choked with financial news. And the public has grasped the fact that this nation cannot continue to operate on the current massive deficit basis. As a result -- finally, finally, I feel the politicians are getting the message. The new "son of Gramm-Rudman" bill is one result. I think this is an early beginning. A US-Russian arms accord could be a second step. An accord could bring about a major slash in US military spending.

The weak bond market has been sending money rates racheting higher. The high rates will bring on a housing and auto slowdown. The public is smart enough to connect rising rates with federal deficits, and I believe the pressure will be increasingly on Washington to get the deficit-cutting job done.

I've predicted this for a long time, and I believe we're seeing the beginning of the phenomenon -- the phenomenon is the markets dictating the economic policy of the US. Nothing is more powerful than the markets, and the money markets are on the verge of saying, "I'm mad as hell, and I'm not going to take it anymore." When that happens, the pressure will be on Congress to cut the deficits. I think it's starting -- I think what we're seeing is the beginning, just the very beginning, of "the big pressure" on Washington.

GREED 1987: How will history describe the world of the late-1980s? In my opinion a single word will sum it up. The word is "greed." The accent on money and "things" and "who's got it" is overwhelming today.

Last week Newsweek came out with a cover story on America's most aggressive young billionaire, Donald Trump. At the same time Town and Country magazine ran a story on Ross Perot, another well-known billionaire. Forbes magazine came out with its cover story on "The Richest Man in the World -- and 95 also rans." Fortune magazine, not to be outdone, came out with another money-money cover story entitled, "The Billionaires, an Inside Look at the More Than 100 People Who Are Worth More Than $1,000,000,000." Meanwhile when first-year MBAs at prestigious Wharton School were asked which firms were most attractive to them, the clear winner was Drexel Burnham Lambert, home of Michael Milken and the "junk bond."

From all quarters we are inundated with the latest "who's richest" or "who controls most" stories. I like money as much as the next guy, and the stock market (in fact all the markets) have always fascinated me. But the current emphasis on wealth and making money seems to be moving toward some sort of crazy crescendo. And I find myself wondering where it will all end.

The stock market always reflects the psychology of the times. So I guess the current 50 and 75 point Dow swings of today are a legitimate reflection of the gambling, hip-shooting, leveraged, adventure stories that are now taking place in America. Of course, a good part of the huge daily (and intra-day) movements are due to the computer buy/sell programs which are currently such an integral part of the Wall Street scene.

Consider this: a computer program says "buy the futures and sell the stocks." The computer (in a matter of seconds) issues sell orders on thousands of shares of stocks, and a major position is liquidated. What stocks are being dumped? The program couldn't care less. This is an arbitrage situation between stock and index futures and it has nothing to do with values.

So ethically what's wrong with computer programs? Nothing, I guess, but to me it's a sign of the times that the stock market has been reduced simply to a big arbitrage situation -- men playing with stocks they care nothing about in a market that is being tossed to and fro by cold, emotionless computers.

In this kind of market, investing becomes difficult and even nerve-wracking. I feel that this is a market where you take a position in certain stocks and hold those stocks, hold 'em until you've had enough. Then you sell them and get out -- and stay out. As for trading, for the average person trading becomes a one-way ticket to disaster in today's markets.

Along these lines I thought the piece on trader Vic Sperandeo in Barron's (Sept. 21) was both fascinating and instructive, and I suggest that all my subscribers read it. A second extraordinary article appeared in the magazine section of the September 20 New York Times. The piece is entitled, "A Nation in Decline?" with the sub-title, "The author fears a deteriorating ethic in the US with incompetence and inefficiency threatening survival." The author is famed historian Barbara Tuchman. If you can possibly obtain this article I urge you to do so. It's an eye-opener.

NOTES & QUOTES: Warren Buffett is generally considered to be the shrewdest and most successful investor in the US. A few years ago Buffett bought 18% of ABC. Now for $700 million he is buying 12% of Salomon Bros. What is he thinking about? The answer, as I see it (and I'm a long-time Buffett buff) is that Buffett is trying to protect himself and his company (Berkshire Hathaway) against inflation. Buffett likes to buy "natural monopolies" and he evidently thinks both ABC and Salomon come close to fitting that description. Buffett believes that in the end the politicians will choose the easy way out of the US debt situation, and the easy way will be to inflate the debt away. At this point, who is so bold as to say that Buffett will be wrong?

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Despite the fact that 85% of the members of Actors Equity are unemployed at any given time, people in the entertainment industry can make BIG money. The winners for '86 were Bill Cosby with an income of $27 million, Stallone $53 mils., Springsteen $29 mils., cartoonist Charles Schulz ("Peanuts") $25 mils., Eddie Murphy $23 mils., Steven Spielberg $27 mils., Madonna $21 mils.

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This Month's Transfers: A Hong Kong conglomerate is buying a 20% interest in old-line Wall Street firm Bear, Stearns for $391 million. A Japanese firm is buying San Diego's plush La Costa resort for $250 million. The Sultan of Brunei (reportedly worth $25 billion) is buying the landmark Beverly Hills Hotel for $200 million from Marvin Davis (I went to high school with Marvin). Marvin always does well; he bought the hotel last December for $135 million.

* *

Clothes: Five years ago one out of every five garments sold in the US was made overseas. Last year half of all garments sold here were made overseas. The giant garment business is fast becoming a matter of designer labels and licensing of clothes that are manufactured overseas.

* *

Eating out: I remember when I was a kid going to a restaurant was an event. My family ate out maybe once a month. Times have changed. Today it's let the good times roll. Forty cents out of every food dollar is spent in restaurants.

But those statistics hardly make the restaurant business an easy affair. According to the Nat. Restaurant Assoc., half of all restaurants fail in their first year, two-thirds by their second year.

How about franchises in general? According to the Nat. Inst. of Business Management (1328 B'way, NYC) the average franchise owner nets only $21,000 a year, can work 12 hours a day seven days a week -- and may still see his business fail.

* *

BIG: Of the 10 largest banks in the world, 7 are Japanese, 2 are French and one (Citicorp) is US. Of the 10 largest corporations in the world, 8 are Japanese and 2 (Exxon and IBM) are US.

* *

Quote of the week by Richard Nixon (from the current Life magazine): "The 20th century has been the bloodiest in history. More people have been killed in the wars of this century than in all the wars fought before the century began. At the same time this century has been the best in terms of material progress. Despite the loss of 130 million lives in war, the world's population has increased from 1.2 billion at the beginning of the century to over 5 billion today. This is due to the massive improvement in health care, food production, housing and per capita income. The most disappointing legacy of the 20th century is the lack of political progress."

* *

"It's an Ill Wind" Dept. Quote by Playboy's Christie Heffner: "People may be choosier now about their social contact, but they certainly haven't lost their interest in the sexual. AIDS makes one's fantasy life all the more important, and the more people drawn to fantasy, the better it is for the magazine."

* *

Financial comment of the week (by advisory publisher Richard E. Band): "Municipal bonds will retain their tax-free status because the most powerful lobby in America (35,000 mayors and governors) will go to bat for them."

* *

Market comment of the week (by my old friend, Jon Strebler): "One of Murphy's corollaries states, 'Whenever a market is performing exactly as expected and its future performance can be predicted with a high level of confidence, that market is then ready to jerk you around.' " Amen.

* *

The Japanese are enjoying the yen's strength. Eighty-five percent of all Japanese newlyweds take their honeymoons in foreign lands. ... Japanese, ever on the lookout for new investment areas for their burgeoning cash, are becoming rabid diamond buyers. DeBeers reports a 60% increase (to $641 million) in diamond sales to Japan in the first six months of 1987 -- this despite a 23% increase in diamond prices over last year.

* *

The rich may be getting richer, but they're also paying more taxes. In 1979 the top 10% of earners paid 49.5% of all US personal taxes. In 1985 they paid 51.8% of all personal taxes. And the top half of all taxpayers shouldered 93.1% of the burden.

* *

Few are aware of it, but the US military budget is scheduled to explode over the foreseeable future. During the next three years 50 major weapon systems are set to go into prototype production. Pentagon officials concede that over the next five years these weapon systems will cost more than $150 billion, this on top of $154 billion already budgeted for existing systems. With Congress bent on cutting the current military budget, this should set the stage for interesting times in Washington.

* *

San Diego County farmers, with the aid of the nation's finest weather, are now producing some exotic and profitable crops. Ostrich farms are springing up as are llama farms, buffalo farms, and fish farms. Starting with seven buffs a few years ago, a herd at Camp Pendleton (north of San Diego) now has grown to over 50 buffs. Buff steaks sell for $14 a pound, and are lower in fat and cholesterol than cattle steak. But it isn't all easy. A huge catfish operation in San Diego County recently had to destroy hundreds of thousands of fish due to disease. They're starting over with 700 healthy fish.

* *

I just bought an amazing book, "Chronicle of the 20th Century" by Chronicle Publications of Mt. Kisco, NY. This is a 1,357-page volume with 3,500 entries and thousands of photos all in terse newspaper fashion detailing the history of the last 87 years. The volume has been acclaimed in five European countries, and I am now acclaiming it. It's fascinating -- a look at history as though you were reading it in today's newspaper. Price is $49.95, and for my money it's a bargain.

* *

Carrots: The Dept. of Agriculture states that two medium-sized carrots a day can reduce the body's cholesterol levels by 10% to 20% due to an ingredient in carrots called calcium pectate (which binds the bile acids). Bugs Bunny should live to 100. Seriously, it's worth trying.

* *

Strike: I can't prove it, but I'm guessing that the team owners are prepared to write off the whole 1987 football season rather than give in to free agency. I also think that many of the smarter players are beginning to sense the same thing. The playing life of the average pro footballer is 3.7 years. If the players miss this year's pay, they're never going to make it back. My prediction -- the players will fold, but it may take a lost season before that happens. As for the fans, polls indicate that they side with the owners.

* *

Do you want the secret of bargain traveling? Marry someone who works for the airlines -- and be young. My oldest daughter, Daria, and her husband (who is a safety officer for PSA) just got back from two weeks in Germany, Austria, Switzerland, and Czechoslovakia. Total cost for both for the two weeks -- $1300. They bought two-week unlimited train travel tickets ($280 a piece) and paid almost nothing for their flight tickets. They visited a different city each day, took their chances on hotels. I asked them, "Did you buy anything?" Answer, "No, prices were too high everywhere except in Prague where there was nothing to buy."

* *

I got a call last night from Tokyo from a subscriber who just got back from Seoul, S. Korea. He works for a major NYSE corp. Here's what he said: "I've lived in most of the major capitals of Europe and Asia. What's happening in S. Korea is absolutely extraordinary. The investment climate there is fabulous; those Koreans are workers. It's like everything good is coming together at once in S. Korea. The Japanese are drooling to invest there; they feel Korea is comparable to Japan in 1964 just before the Japanese sponsored the Olympics. S. Korea is THE coming nation.

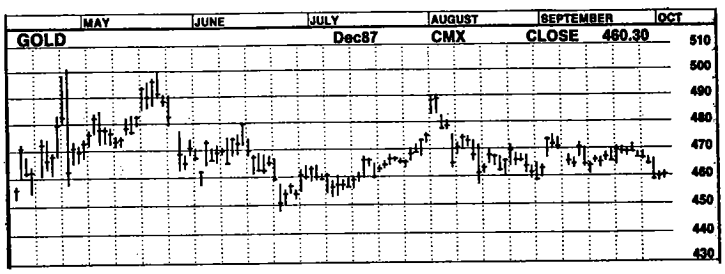
* *

GOLD, CHARTS, COMMENTS: On September 30 Treasury Secretary Baker came out with a proposal to reintroduce gold into the world monetary system, but Baker's concept would have gold treated as just another item in a basket of commodities. The basket would be used to gauge economic policies. The policies would probably be aimed at stabilizing the monetary system with particular emphasis on the dollar.

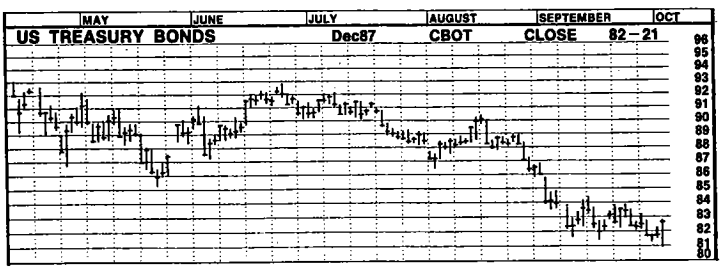
Gold immediately dropped $5 on the theory that (a) the yellow metal might be perceived as just another commodity like wheat or cotton, and (2) if the central banks were serious about stabilizing the dollar, well heck, who needs gold?

The Russell opinion: Gold is going to look like gold and act like gold regardless of what Baker or anyone else proposes. The fact is that there hasn't been very much inflation among the developed nations. Furthermore, it's obvious that if even the perception of inflation creeps in, interest rates are going to rocket up and kill both inflation and the economy that produces it.

The daily chart of the December gold contract shows the metal in a listless trading range between 450 and 490. There is some support at 458 and more important support at 450. The 144-day moving average for gold also comes in at around 450, so this is where the solid support is. Remember, gold has a longtime habit of making an important low during the fourth quarter of each year. I think we're going to see that again in 1987 .

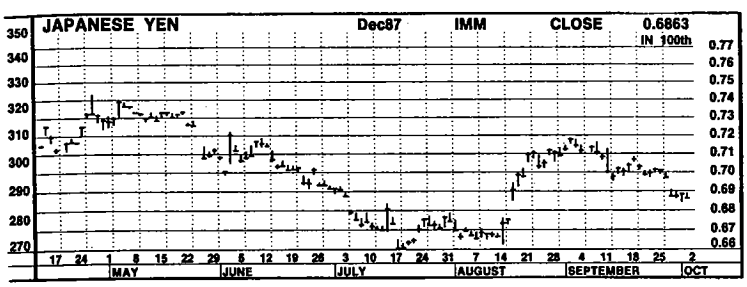


Everything today is tied together so let's treat it that way. First, the daily chart of T-bonds shows the bonds taking a bath but maybe fishing for a bottom around 80 (where many listed T-bonds at the long end are actually yielding 10% or slightly more).

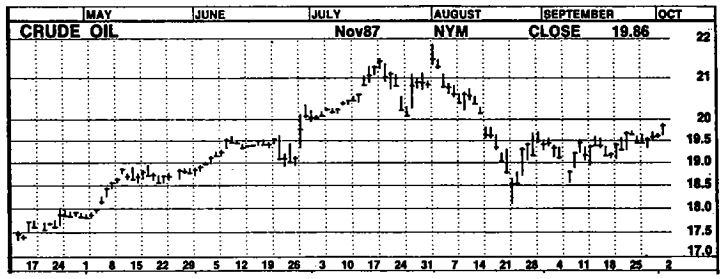


Furthermore, the new Gramm-Rudman bill does have some teeth in it, and for this and other reasons the dollar has turned stronger against the major currencies.

This chart of the December yen contract shows the top in the yen back in April at 74, a second lower top in September at 72 and last week's gap breakdown below 69.



Crude oil, the world's "black gold," seems to have stabilized around 19.50. But the long-term implications for oil are rather interesting. A few years ago the US imported around 35% of its oil. Right now we're importing nearer 45%, with last July hitting 50% (this has happened only once before). It is estimated that by the end of the century we could be importing 60% to 65% of our oil, unless we come up with a new fuel. So the future of oil is extremely attractive, and only one item could come along to mess up oil's future. That item, of course, would be a world depression.



LATE NOTES: The amount of nonsense written about the Dow Theory continues to amaze (and depress) me. For the latest study in ignorance, read the letter to the editor ("A Trader's Story") in the Oct. 5 Barron's, page 9. The writer talks about Dow Theory in terms of head-and-shoulder formations and downside Dow Theory targets. Of course Dow Theory deals with nothing of the sort. The letter is simply an exercise in ignorance.

I've received a slew of mail about **DowPow.** It seems everyone likes this new indicator, and many subscribers are over-working their computers, trying to figure out how DowPow is constructed. One subscriber, a computer expert, has figured it out. He has taken DowPow back six years, and his chart shows DowPow walking up a perfect five-year trendline, a trendline which intersects DowPow at about 570. That September low on DowPow (see page 3 chart) had better hold.

My PTI continues to hold stubbornly above its moving average. The PTI is still my "fail-safe" indicator, the one that keeps me thinking right about this market. No matter how thin the values, no matter how extended the market rise, no matter how badly the breadth lags, until the PTI breaks below its moving average -- the PTI states, "You can't be a bear."

The rally from the September lows (page 1 chart) already qualifies as a full correction of the August-September decline. Thus Dow Theory is now in play. If both Averages advance through their highs, it's a reconfirmed bull market. If both Averages break the September lows, the bull is dead.

Strangely, we haven't had a big upside day in breadth since the September lows, not a single day so far with as many as 1100 advances. Consequently, the A-D ratio has lagged as has DowPow. A new high on the Dow (above 2722.42) with another breadth non-confirmation would hardly be a plus for the bulls.

The bonds are groping for a bottom. I could be wrong, but I thought the action of Oct. 2 smacked of a bottom. The Dec. T-bond contract opened down 24/32nd, then finished UP almost a point in what appeared to be a classic "one-day reversal."

In Letter 971 (page 6) I showed where the dollar index had reversed a long declining trendline on the chart, and I stated that in my opinion the dollar has bottomed. I still feel that way, and I believe we are going to see the reason why shortly — (1) better US trade balance figures (2) better numbers on the federal deficit, and (3) a dollar that looks very cheap on a "purchasing parity basis."

THIN VALUES: The latest statistics on yields show Barron's AAA-rated bonds (yielding 10.6%) providing a mind-blowing yield advantage of 7.99% as against the yield on the Dow (which is now 2.61%). Value for value, compared with stocks, they're giving the bonds away.

Conclusion: With the dollar and bonds probably bottoming, with the trade balance and the fed deficits about to improve, with US unemployment below 6% for the first time in eight years, with real GNP probably increasing at a 3% rate, the market has every reason to be going up. So let's watch carefully and let's keep in mind that *when the market isn't doing what it should be doing, it's time to rethink your scenario and to be careful.*